FT DUE DILIGENCE FORUM: PRIVATE EQUITY AND THE COVID CRISIS
Kaye Wiggins, private capital correspondent, Financial Times
Lionel Assant, senior managing director and European head of private equity, Blackstone
Christian Sinding, chief executive and managing partner, EQT Partners
Alain Carrier, senior managing director and head of international, head of Europe, CPP Investments

Kaye Wiggins, the FT’s private capital correspondent, moderated a discussion on the challenges and opportunities for private equity investors during the Covid-19 pandemic.

She noted that on the eve of the first national lockdowns, PE was “on a high”. She pointed to Thyssenkrupp’s sale of its elevator division for €17.2bn to Advent and Cinven in February, the biggest PE deal in Europe for more than a decade.

Since then, the global economy has turned downwards. Further uncertainty has been caused by geopolitical issues, including the bitterly fought US election and whether the UK will manage to strike a deal with the EU.

How should PE investors approach challenge and opportunity in the era of Covid-19? The FT Due Diligence Forum invited a panel of experts to discuss this.

Below are the highlights of the event.

THE PE COVID STRATEGY: SEIZING OPPORTUNITIES WITH CAUTION

Christian Sinding said EQT has learnt from its mistakes and had opted to be active during the crisis. He said that historically “we haven’t been good enough at taking opportunities during times of dislocation”. EQT has focused on sectors that have done well, or at least not suffered, during the crisis, including telecoms, healthcare and infrastructure.

Lionel Assant acknowledged that Blackstone was cautious in the first months of the crisis, particularly in relation to traditional PE “where you buy control of entire businesses”. He said the time had been spent supporting companies in his firm’s portfolio rather than looking for new companies to buy. “We needed to take stock of what was happening. It’s always very difficult … when you don’t know exactly how deep the crisis is,” he said.

At CPP Investments, which Alain Carrier said remained “fully invested” in the PE market, there has been less room for manoeuvre. “We don’t have dry powder [cash reserves],” he said. As a result, the firm had to decide if new opportunities were “better” than those already in its portfolio. Like Blackstone, CPP had concentrated on its existing companies. “A number of them needed capital, needed focus,” Mr Carrier said.

INVESTMENT IN THE THIRD QUARTER: HOW THE APPROACH IS CHANGING

Mr Assant said while Blackstone was “slightly cautious in the second quarter”, it had started to seek opportunities. Already, it has invested in three businesses, taking $4 billion of equity in companies that Mr Assant described as “Covid-proof”.

Mr Sinding said EQT was trying to “continue as we normally do”. This has meant trying “to find good companies to invest in, that are positive for the future of the world”.

Mr Carrier, meanwhile, said CPP was starting to focus “on sectors that we think are going to be incredibly important to us” and also on the ramifications of changes in consumer behaviour triggered by the crisis. CPP is looking especially at the delivery of healthcare services, the future of cities and the diversification of supply chains.

He said CPP’s long-term focus meant it was under no pressure to make a choice. As pension fund investors, the firm “has the luxury of long-term thinking”.

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WHY CONTINUATION VEHICLES ARE ALL THE RAGE

The number of “continuation vehicles”, as PE insiders call them, is increasing. These vehicles are investment strategies in which a PE firm switches a company between its funds rather than offer it to another firm or take it public via an initial public offering.

Blackstone completed such a deal in October when BioMed Realty, the largest private owner of life-science office buildings in the US, was transferred from one Blackstone fund to another for $14.6 billion. Likewise, in July, EQT switched IFS, a software company, from the EQT VII fund to the EQT VIII fund, the EQT IX fund and one other fund for “a transaction value in excess of €3 billion”.

This kind of transaction is hardly traditional PE practice, which is to buy a company, boost value and then sell. So what is the point?

Mr Assant said “continuation” deals were “definitely a trend” although he did not “think ... it is a trend that’s here to stay”. He said there were some large, high-quality assets “which our investors wanted to own for the longer duration”.

Adding to the list of benefits, Mr Sinding said continuation vehicles ensured that companies could avoid management time spent on transactions as well as costs and fees that would usually go to bankers and other intermediaries.

Mr Sinding said, however, that continuation vehicles made sense “[only] for certain assets where you have the confidence, drive and vision to take this company far into the future”.

Mr Carrier agreed that these vehicles had a place but warned that, if they became too popular, they would reduce the number of deals coming to market, which could damage the PE business.

SPECIAL-PURPOSE ACQUISITION COMPANIES ‘ARE NOT A THREAT’, DESPITE WHAT LARRY FINK THINKS

So far this year 133 Spacs (special-purpose acquisition companies) have been created in the US. These stock exchange-listed companies present a threat to traditional PE firms, according to Larry Fink, the chief executive of Blackrock.

Spacs, which are sometimes dubbed “blank cheque” companies, raise funds from investors and then merge with a private company. In effect they are a fast-track way to go public and avoid an IPO.

Mr Assant said such companies were not a threat, certainly not to big groups such as Blackstone. He said Spacs were small and focused on small firms. “We have a $26 billion fund so I don’t think we will see them as a threat, certainly for the foreseeable future.” Though he did add: “Never say never.”

Mr Assant said Spacs presented an opportunity “because they offer exit optionality with speed in execution: a less tedious process than a classic IPO”. Mr Sinding said Spacs were an indication “that IPO markets are not functioning well”.

WHY LIVE ENTERTAINMENT BUSINESSES ARE NOT DEAD

The coronavirus has dealt a blow to companies involved in live entertainment but major investors, including Blackstone and CPP, are confident that the best groups will bounce back. People have “short memories”, said Mr Assant. Businesses that fall out of favour during a crisis can and do stage a comeback.

He acknowledged that live entertainment, together with travel, energy and other leisure businesses, had suffered because of national lockdowns. “But do I think that people will go back on planes? Yes. Do I think that people will go back to the London Eye? Absolutely. Will they go back to events? Yes. I just don’t know if it’s going to be in one, two or three years’ time.” Mr Assant did, however, say that many businesses still needed to adapt to the digital environment. “It is entirely possible that you get a ‘rerailing’ rather than a derailing of these businesses,” he said. This would mean, for example, that companies may have to switch from being “100 per cent physical to being 70 per cent physical and 30 per cent digital”.

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HOW PE INVESTORS SEE THE HEALTHCARE OPPORTUNITY

The pandemic has sparked a huge healthcare opportunity, but how do PE investors approach the possibilities?

Two years ago, Blackstone acquired Clarus, a life sciences company, and renamed it Blackstone Life Sciences. It created a fund to support big pharmaceutical companies through expensive clinical trials. Mr Assant said the firm’s probable involvement in clinical trials for an effective vaccine was an “obvious way to ‘play’ Covid”.

For its part, in April EQT bought Schülke, a specialist hand-sanitiser company. Mr Sinding said it was a timely purchase. The challenge is to make the group viable in the long-term, once Covid-19 is under control. “Can we transform this company and make it even more future-proofed?” he said. “Is it delivering a service or a product that’s actually good for the world for the long-term?”

POLITICAL RISK AND DEPLOYING CAPITAL

Mr Carrier said “Brexit has thrown a bit of uncertainty” into investment calculations. He noted that some companies would be affected to a greater degree: “You really have to do the work and look at the specific assets,” he said. He reported that CPP had “found great deals in real estate in the UK post-Brexit”.

Mr Assant said: “We are in the risk business: When you try to make two to three times your money, it doesn’t come without risk.” He said Blackstone had “taken Brexit risk” but noted that “we’re going to ask to be paid for the premium”.

Mr Sinding said Brexit would throw up unexpected opportunities. “It might scare some people away,” he observed, “so if you’re actually on the ground with the team and you have an angle and you know how to develop that company or asset, then it might be the opportunity that you get to buy that company.”

CURRENT MARKET VALUATIONS

Mr Sinding said valuations were high because interest rates were low — and so investors desperate to deploy capital were choosing the stock market and forcing up prices. He insisted there were still some promising investments. He said EQT investors looked for a company with “a good platform that we can buy today and create something much more valuable”.

Mr Assant said valuation was only “one element” in investors’ calculations. He pointed also to the investment theme, “[where you] invest in themes that you believe in and where the tailwinds will be your friend for the long-term”, as well as the propensity for a company to be “transformed from within”. He said to invest in companies, typically the large carve-outs from big multinationals, if “you think you can run them better”.

Mr Carrier said interest rates were not going to rise significantly soon so, despite inflated prices, investors should look for companies that “deliver good relative value”.

IS THERE AN APPETITE TO INVEST IN DISTRESSED ASSETS?

Mr Assant said: “Surprisingly, the amount of distress out there is quite limited”. Nevertheless, he said Blackstone’s fund managers would invest in a distressed company if they thought “it will come out of the crisis in good shape because they have a raison d’être”.

Mr Sinding said EQT was less likely to invest in distressed companies: “We’re more tilting towards those companies where the platform is still fairly healthy and where we can accelerate it.”

Mr Carrier said CPP had “made those calls”. It continued to invest in companies that, while “in some distress”, possess “a sound business model” and are predicted to emerge strongly when the economy rebounds.

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